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VISA U.S.A. INC.

BOARD OF DIRECTORS MEETING

Foster City, California
January 20, 1999

Interchange Reimbursement Fees

Introduction

Recommendations for April 1999 changes to Visa's interchange reimbursement fees will be presented at the special meeting of the Board of Directors currently scheduled for January 20. This document reviews the previously approved 1999 interchange rates, provides an overview of the competitive and market developments since their approval, discusses other considerations in evaluating changes to interchange fees and details additional recommendations for April 1999 implementation.

Proposal Summary

The following is an outline of management's interchange fee proposal:

- Increase Visa interchange fees an average of 3 percent (individual rate increases ranging from 0 to 13 basis points). If adopted, the proposal would narrow the difference between the Visa consumer and commercial rates and MasterCard's new, higher rates, the latter a consequence of MasterCard's most recent increase. Narrowing this gap will enhance the competitive position of Visa card products for Issuers, particularly with respect to check card.
- Compliment these rate increases with continued investments in Visa's merchant acceptance initiatives, including the Volume-Tiered Interchange Fee Pilot program. Recommendations to increase current program incentives, to offset additional rate increases to Volume-Tier participants, will preserve the viability of current partnership agreements while, we believe, shifting share to Visa card products.
- Modify Visa's Interlink interchange fees, applicable to PIN-based retail and supermarket transactions, to address competitive developments and enhancing Issuer participation in the Interlink service.

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Background -- May 1998 Board Meeting

In May 1998, the Board approved a number of modifications to Visa interchange reimbursement fees to address competitive positioning challenges and the viability of the Volume-Tiered Interchange Fee Pilot. These changes included increases to Visa consumer credit and check card interchange fees, as well as enhancements to the Volume-Tiered Interchange Fee program. The April 1999 changes to Visa's fee structure were announced to the Membership and marketplace in June 1998.

Consumer Credit and Check Card Product Interchange Fees

A number of market conditions discussed with the Board in May 1998 suggested the need to increase Visa consumer product interchange rates. The key factors contributing to management's recommendations were the significant competitive market share risks associated with the current interchange differential with MasterCard (primarily on check card) and the continuing economic and cost pressures experienced by Visa Issuers.

For these reasons, at its May 1998 meeting, the Board approved increases to Visa interchange rates of 4 percent on consumer credit products and 8 percent on the check card product. No changes were made to Visa commercial products. The consumer product increases included the impact of fee reductions made available to select merchants and their Acquirers in the Volume-Tiered Interchange Fee Pilot program. Attachment A details the April 1999 changes to Visa interchange fees, approved at the May 1998 Board meeting.

Enhance the Volume-Tiered Interchange Fee Pilot Program

The Board at its May 1998 meeting also approved changes to the Volume-Tiered Interchange Pilot to further strengthen strategic partnerships with leaders in the merchant community. These program modifications preserve the viability of the two-year program, which was launched in April 1998, as well as to shift share to Visa products at the point of sale. The implementation of a market segmentation approach to interchange rates, albeit within the framework of calculated (cost-based) rates, is a key element of Visa's long term interchange rate positioning.

Effective execution of the 1999 fee increases is dependent upon a strategic view of the Volume-Tiered Interchange Fee program. Increases in rate incentives together with pilot participation by key merchant partners are critical to achieving the objective of supporting Visa's competitive financial business case. Current program results suggest that the probable net interchange fee impact to Issuers associated with the May 1998 approved

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Volume-Tiered Program will be around 2.5 basis points, with a maximum impact of 4 basis points. Changes to Volume-Tiered Interchange Fees, approved at the May 1998 Board meeting for April 1999 implementation, are found in Attachment B.

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Recent Market Developments

Competitive Environment

In late November 1998, MasterCard announced comprehensive increases to its interchange reimbursement fees, effective April 1999. By widening the MasterCard interchange advantage for card Issuers, these MasterCard interchange rate modifications potentially will have a significant adverse effect upon Visa card issuance. The MasterCard rates just announced are currently projected to be higher than Visa by 6 basis points on consumer credit, 14 basis points on debit, and approximately 8 basis points on commercial products.

While interchange fees are only one factor for Issuer consideration in choosing brand, and while Visa is able to offset a significant portion of these rate differences through lower transaction processing and membership fees as well as superior brand positioning, it is unlikely that these factors will be sufficient to offset the appeal to Issuers of much higher MasterCard rates. Additionally, as MasterCard has had higher interchange fees than Visa for a number of years, the differential has continued to increase in recent years and now presents an even more serious competitive threat. Further, MasterCard's higher interchange fees are generally less visible to merchants because Acquirers tend to blend MasterCard's rates with Visa's and because MasterCard's smaller market share has a less visible effect.

Implementation Issues

An additional challenge in addressing this issue is the limited implementation options available in making changes to 1999 interchange fees. The bankcard associations have committed to a systems freeze after the April 1999 implementation, in accordance with Year 2000 initiatives. As subsequent systems availability may not occur until June 2000, it appears that the April 1999 systems release may be the only opportunity for interchange rate changes for 15 months. Further, at the present time, Acquirers are preparing merchant notification of April 1999 pricing changes. The majority of these notifications will begin in January. Therefore, a timely decision is necessary on April 1999 interchange fees, in order to minimize considerable Member impact.

Other Environmental Considerations

Of course, there are risks associated with another Visa rate increase:

- Merchant reaction will surely be negative, even within the merchant segments that benefit from an extension of the Tiered Interchange Pilot;
- Visa's rates would be close to American Express in some segments;

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- The continued increase in the cost of bankcard (and general purpose payment card) acceptance may encourage merchants to offer discounts for other forms of payment, such as cash and checks, and might encourage a resurgence of proprietary cards;
- A strong negative merchant reaction could cause more scrutiny of these issues in the Wal-Mart litigation or even in the case recently brought by the Justice Department against the bankcard associations; and
- Although less likely, there is always a risk of negative publicity.

Nonetheless, management is of the view that these risks are outweighed by the risks to the Visa brand and to member profitability that exist if the MasterCard higher interchange fee is not addressed.

April 1999 Interchange Reimbursement Fee Recommendations

Accordingly, management recommends a number of modifications to Visa interchange reimbursement fees as well as an extension of the Volume-Tiered Interchange Fee pilot. These recommendations are summarized as follows:

Increase Visa Consumer and Commercial Product Interchange Fees

MasterCard's current interchange rate advantage over Visa already presents a significant challenge in securing Visa brand issuance decisions; a further widening of the gap as a consequence of MasterCard's new increase for April 1999 is unacceptable. The 14 basis point lower Visa check card interchange rate to Issuers would likely result in conversion to MasterCard of considerable Visa branded portfolios. Further, Visa's share of new credit and commercial business would certainly be reduced. In summary, management estimates that absent additional changes to Visa interchange reimbursement fees, Visa volume could be impacted by as much as \$50 billion over the next two years, with an estimated 3 percent impact on bankcard market share.

Management recommends rate increases in order to compete more effectively with MasterCard for brand issuance decisions. With Visa's product and fee advantages, the interchange fee variance need only be reduced to 3 or 4 basis points to meet the objectives of maximizing total Visa system output.

The impact of management's fee recommendations, *assuming full participation in the Volume-Tiered Fee Pilot*, are as follows:

- Reduce the consumer credit product interchange fee differential from 6 basis points to 3 basis points,
- Reduce the consumer off-line debit product (check card) interchange fee differential reduced from 14 basis points to 4 basis points, and
- Eliminate the commercial card product interchange fee differential.

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Specific interchange rate recommendations are outlined in Attachment C.

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Enhance the Volume-Tiered Interchange Fee Pilot Program

Additional changes to Visa's Volume-Tiered Interchange Fee incentives are recommended for April 1999. These changes will accomplish the following objectives, both critical to the success of Visa's interchange reimbursement fee strategy:

- Enhancement of the pilot incentives will ensure stability and further encourage mutually advantageous merchant partnerships, structured to increase Visa volume and move payment market share. Considerable resources have been dedicated to negotiate and execute contracts with the largest merchants and their Acquirers in order to meet the pilot's objectives of improving Visa brand promotion and market share within the acceptance community. New, unanticipated interchange increases to the merchants in this program would result in significant reconfiguration of contracts and certainly reduce participation.
- Market disruption associated with additional April 1999 interchange fee increases would be reduced by modifying the Volume-Tiered Interchange Fee rates. Visa's long term rate positioning is benefited through a market segmentation strategy that reflects the rate sensitivity, volume, and value contributed by these largest customers (through Visa promotional efforts), all within the context of calculated rates.

Current program participation and contract negotiations suggest that the probable net interchange fee impact to Issuers associated with this enhanced, April 1999 Volume-Tiered program would be less than 3.5 basis points, with a maximum impact of approximately 5 basis points. Volume-Tiered Interchange Fee recommendations for April 1999 are found in Attachment D.

Modify Visa Interlink Interchange Rates

In recent months, the two largest regional ATM/POS networks have announced considerable increases to their point-of-sale interchange fees. These rate increases have resulted in risk to Issuer participation in the Interlink network. The Interlink service and mark primarily support Members' need for non-Visa branded PIN-based processing of debit purchase transactions.

Given the risk associated with this competitive development, management recommends the first Interlink interchange rate increase since 1992, effective April 1999. The proposal, outlined in Attachment E, increases the Interlink Supermarket per transaction interchange fee from ten cents to fourteen cents. In addition, Interlink's rate on retail volume would be modified from forty-five basis points with a maximum of twelve cents, to forty-five basis points plus two cents with a maximum of twenty cents.

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Conclusion

Recommendations will be presented for Visa and Interlink 1999 interchange fee increases and enhancements to the interchange fee incentives associated with the Volume-Tiered Interchange Fee Pilot program.

Management will give a brief overview of the issues surrounding these interchange reimbursement fee recommendations at the Board meeting, incorporating the competitive developments noted above and comments on the proposal from Member institutions visited. Recommendations for approval of these new rates will be presented, with implementation in April 1999. Resolutions are enclosed that summarize these interchange rate proposals.

Ronald J. Schmidt

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ATTACHMENT A – Interchange Reimbursement Fees

Consumer Credit and Check Card Interchange Rates
(Actual April 1998 and Approved April 1999)

<u>Existing Fee Category</u>	<u>April 1998 Rate</u> (Actual)	<u>April 1999 Rate</u> (Approved)	<u>Change</u> (Percent)
CPS/Retail Credit	1.31%	1.45%	11%
CPS/Retail Credit 2 (New Mkts)	1.43% + \$0.05	1.43% + \$0.05	--
CPS/Hotel & Car Rental CP*	1.43% + \$0.05	1.53% + \$0.05	7%
CPS/Hotel & Car Rental CNP*	1.43% + \$0.05	1.53% + \$0.05	7%
CPS/Card not Present	1.65% + \$0.05	1.75% + \$0.05	6%
CPS/Automated Fuel	1.40% + \$0.05	1.50% + \$0.05	6%
CPS/Supermarket Credit	1.15%	1.20%	4%
CPS/Passenger Transport CNP	1.65% + \$0.05	1.70% + \$0.05	3%
Express Payment Service	2.02% + \$0.02	2.02% + \$0.02	--
Electronic Interchange Rate	1.81% + \$0.10	1.91% + \$0.10	5%
Standard Interchange Rate	2.09% + \$0.10	2.17% + \$0.10	4%
CPS/Retail Check Card	1.04% + \$0.06	1.16% + \$0.10	17%
CPS/Supermarket Check Card	\$0.36	\$0.40	11%

* CP=Card Present, CNP=Card Not Present, PT=Passenger Transport

Commercial Interchange Rates
(Actual April 1998 and Approved April 1999)

<u>Fee Category</u>	<u>April 1998 Rate</u> (Actual)	<u>April 1999 Rate</u> (Approved)	<u>Change</u> (Percent)
Commercial Card Standard:			
T&E Volume	2.22% + \$0.10	2.22% + \$0.10	--
Non-T&E Volume w/Data	2.09% + \$0.10 *	2.17% + \$0.10 *	4%
Non-T&E Volume w/o Data	2.22% + \$0.10	2.22% + \$0.10	--
Commercial Card Electronic:			
T&E Volume	2.02% + \$0.10	2.02% + \$0.10	--
Non-T&E Volume w/Data	Mix*	Mix*	Misc
Non-T&E Volume w/o Data	2.02% + \$0.10	2.02% + \$0.10	--

* Consumer rates vary, noted above, applying to non-T&E volume w/data, & impacted by the proposed consumer increases.

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ATTACHMENT B -- Volume Tiered Interchange Fee Pilot Program

<u>Volume Tiered Interchange ¹</u> <u>(Effective April 1998)</u>			
<u>Total Merchant Annual Visa Volume ²</u>		<u>Rate Reduction ³</u>	
<u>Current Program</u>			
Over \$2.0 Billion/Under \$3.5 Billion		2 basis points	
\$3.5 Billion and Over		5 basis points	
<u>Interchange Fee Reduction (approved for April 1999 implementation)</u>			
<u>Merchant Segment</u>	<u>Tier 1</u> <u>(\$3.5B)</u>	<u>Tier 2</u> <u>(\$2.0B)</u>	<u>Tier 3</u> <u>(\$750M)</u>
<i>Level of Interchange Rate Reduction ⁴ (bp)</i>			
Retail	21bp	18bp	8bp
Supermarket	13bp	10bp	4bp
Oil	15bp	12bp	5bp
Direct Marketing	15bp	12bp	5bp
Airlines	11bp	8bp	3bp
Hotel/Car Rental	15bp	12bp	5bp

¹ Applicable to retail, supermarket, fuel, airline, direct marketing, lodging and car rental merchants, as defined by parent company owned or legally affiliated merchants in Visa approved category codes.

² Volume tiers will be indexed annually based upon Visa growth and apply tiered pricing on all original and exception items.

³ Merchants must meet quality performance standards, in addition to brand signage and marketing requirements to receive reductions.

⁴ Includes on-line debit Visa volume for qualification but not for volume-tier discount. Actual basis point reduction will be determined, in part, by start date of participation in the pilot program.

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ATTACHMENT C – Interchange Reimbursement Fees

Consumer Credit and Check Card Interchange Rates
(Previously Approved for April 1999 and Updated Proposal for April 1999)

<u>Existing Fee Category</u>	<u>April 1999 Rate</u> (Approved)	<u>April 1999 Rate</u> (Proposed)	<u>Change</u> (Percent)
CPS/Retail Credit	1.45%	1.38% + \$0.05	--
CPS/Retail Credit 2 (New Mkts)	1.43% + \$0.05	1.43% + \$0.05	--
CPS/Hotel & Car Rental CP*	1.53% + \$0.05	1.58% + \$0.10	6%
CPS/Hotel & Car Rental CNP*	1.53% + \$0.05	1.58% + \$0.10	6%
CPS/Card not Present	1.75% + \$0.05	1.80% + \$0.10	6%
CPS/Automated Fuel	1.50% + \$0.05	1.50% + \$0.05	--
CPS/Supermarket Credit	1.20%	1.20%	--
CPS/Passenger Transport CNP	1.70% + \$0.05	1.70% + \$0.05	--
Express Payment Service	2.02% + \$0.02	2.02% + \$0.02	--
Electronic Interchange Rate	1.91% + \$0.10	2.00% + \$0.10	4%
Standard Interchange Rate	2.17% + \$0.10	2.30% + \$0.10	6%
CPS/Retail Check Card	1.16% + \$0.10	1.25% + \$0.10	6%
CPS/Supermarket Check Card	\$0.40	\$0.40	--

* CP=Card Present, CNP=Card Not Present, PT=Passenger Transport

Commercial Interchange Rates
(Previously Approved for April 1999 and Updated Proposal for April 1999)

<u>Fee Category</u>	<u>April 1999 Rate</u> (Approved)	<u>April 1999 Rate</u> (Proposed)	<u>Change</u> (Percent)
Commercial Card Standard:			
T&E Volume	2.22% + \$0.10	2.35% + \$0.10	6%
Non-T&E Volume w/Data	2.17% + \$0.10 *	2.30% + \$0.10 *	6%
Non-T&E Volume w/o Data	2.22% + \$0.10	2.35% + \$0.10	6%
Commercial Card Electronic:			
T&E Volume	2.02% + \$0.10	2.10% + \$0.10	4%
Non-T&E Volume w/Data	Mix*	Mix*	Misc
Non-T&E Volume w/o Data	2.02% + \$0.10	2.10% + \$0.10	4%

* Consumer rates vary, noted above, applying to non-T&E volume w/data, & impacted by the proposed consumer increases.

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ATTACHMENT D -- Volume Tiered Interchange Fee Pilot Program

<u>Volume Tiered Interchange ⁵</u> <u>(Effective April 1998)</u>			
<u>Interchange Fee Reduction (previously approved for April 1999)</u>			
<u>Merchant Segment</u>	<u>Tier 1</u> <u>(\$3.5B)</u>	<u>Tier 2</u> <u>(\$2.0B)</u>	<u>Tier 3</u> <u>(\$750M)</u>
<i>Level of Interchange Rate Reduction ⁶ (bp)</i>			
Retail	21bp	18bp	8bp
Supermarket	13bp	10bp	4bp
Oil	15bp	12bp	5bp
Direct Marketing	15bp	12bp	5bp
Airlines	11bp	8bp	3bp
Hotel/Car Rental	15bp	12bp	5bp
<u>Interchange Fee Reduction (updated proposal for April 1999)</u>			
<u>Merchant Segment</u>	<u>Tier 1</u> <u>(\$3.5B)</u>	<u>Tier 2</u> <u>(\$2.0B)</u>	<u>Tier 3</u> <u>(\$750M)</u>
<i>Level of Interchange Rate Reduction ⁷ (bp)</i>			
Retail	23bp	20bp	10bp
Supermarket	13bp	10bp	4bp
Oil	23bp	20bp	13bp
Direct Marketing	26bp	23bp	16bp
Airlines	13bp	10bp	5bp
Hotel/Car Rental	22bp	19bp	12bp

⁵ Applicable to retail, supermarket, fuel, airline, direct marketing, lodging and car rental merchants, as defined by parent company owned or legally affiliated merchants in Visa approved category codes.

⁶ Includes on-line debit Visa volume for qualification but not for volume-tier discount. Actual basis point reduction will be determined, in part, by start date of participation in the pilot program.

⁷ Includes on-line debit Visa volume for qualification but not for volume-tier discount. Actual basis point reduction will be determined, in part, by start date of participation in the pilot program.

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ATTACHMENT E – Interlink Interchange Reimbursement Fees

<u>Interlink Point-of-Sale Interchange Fees</u> <i>(Proposed for April 1999)</i>		
<u>Merchant Segment</u>	<u>Current IRF</u> (Actual)	<u>April 1999</u> (Proposed)
* Supermarkets	\$0.10	\$0.14
* All Others	0.45% Maximum \$0.12	0.45% + \$0.02 Maximum \$0.20

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VISA U.S.A. INC.
BOARD OF DIRECTORS MEETING

Foster City, California
January 20, 1999

INTERCHANGE REIMBURSEMENT FEES

In order to adopt changes to certain Interchange Reimbursement Fee rates,
upon motion duly made, seconded and unanimously carried, it was

RESOLVED, that the changes to the Interchange Reimbursement Fees shown in Exhibits C, D and E, which shall be attached to the minutes of this meeting, be, and hereby are adopted, to take effect on the date shown in said Exhibit;

And be it further

RESOLVED, that management prepare amendments to the Operating Regulations implementing these changes to the Interchange Reimbursement Fees to be published and to take effect without further action by the Board.